Stock Note

Electrosteel Castings Ltd

May 16, 2023

RETAILRESEARCH

Electrosteel Castings Ltd

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Pipes and Fittings	Rs. 47.15	Buy in the band of Rs 47 – 48 and add on dips in the band of Rs 41.5 – 42.5	Rs. 52.75	Rs. 57	2 - 3 quarters

HDFC Scrip Code	ELECASEQNR
BSE Code	500128
NSE Code	ELECTCAST
Bloomberg	ELSC:IN
CMP May 15, 2023	47.15
Equity Capital (Rs cr)	59.5
Face Value (Rs)	1.0
Equity Share O/S (cr)	59.5
Market Cap (Rs cr)	2800.6
Book Value (Rs)	73.8
Avg. 52 Wk Volumes	1453785.3
52 Week High	48.5
52 Week Low	26.5

Share holding Pattern % (Mar 2023)	
Promoters	44.08
Institutions	16.70
Non Institutions	39.22
Total	100.00

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

Fundamental Research Analyst
Nirmam Mehta
nirmam.mehta@hdfcsec.com

Our Take:

Electrosteel Castings Ltd. (ECL) was incorporated in 1955 and is a pioneer in the manufacturing of Ductile Iron Pipes (DI Pipes) in India. The company caters to various government bodies as well as large marquee public companies in India. ECL has established dominant position in the domestic ductile pipes industry with significant backward integration. It also has a strong foothold in the international market catering to customers across Europe, USA, South America, Middle East, South East Asia and Africa. The plants of ECL are located in eastern and southern India, tapping different markets in the country. The company has manufacturing units at the following locations - Khardah, Haldia and Bansberia in West Bengal, Elavur in Tamil Nadu and Srikalahasthi in Andhra Pradesh.

ECL is undertaking a capacity expansion in the DI pipes segment increasing the capacity from ~7 LTPA to ~9 LTPA by March 2024. The company is expected to generate steady cash flows and improved profitability over the medium term, backed by its established market position, high operating efficiency and diversified manufacturing base catering to various customers. Merger of Srikalahasthi Pipes Limited (SPL) with ECL effective from 31st December 2021 has led to economies of scale as well as more than ~24% of the total domestic market share in terms of operational capacity.

Valuation & Recommendation:

There is a strong demand for DI pipes given the government's focus on public infrastructure and the Jal Jeevan and AMRUT missions. We like the company for its market leadership in the domestic ductile iron pipes industry and robust operating parameters driven by backward integration and healthy cash generating ability. Both ECL and SPL have high level of backward integration in terms of a sinter plant, sponge iron unit, coke oven plant, power plant, ferroalloy plant and cement plant. This high level of backward integration has aided the group in maintaining the high quality of its products, leading to better profitability. With the upcoming capacity expansion, ECL is expected to further consolidate its leadership position in the market. We expect the company to grow its Revenue/EBITDA/PAT at a CAGR of 20%/15%/13% over FY22-25E. Q4FY23 numbers could be better because of lower raw material costs.

We think the base case fair value of the stock is Rs 52.75 (6.25x FY25E EPS) and the bull case fair value is Rs 57 (6.75x FY25E EPS) over the next two-three quarters. Investors can buy the stock in the band of Rs 47 - 48 (5.6x FY25E EPS) and add more on dips in the band of Rs 41.5 – 42.5 (5x FY25E EPS).

Financial Summary (Consolidated):

Particulars (Rs cr)	Q3FY23	Q3FY22	YoY-%	Q2FY23	QoQ-%	FY21	FY22	FY23E	FY24E	FY25E
Operating Income	1852	1438	28.8	1784	3.8	3,474	5,281	7,404	7,996	9,116
EBITDA	187	190	-1.2	154	21.4	434	698	792	880	1,048
APAT	78	97	-18.8	53	48.4	-91	347	330	378	502
EPS (Rs)	1.3	1.6	-18.8	0.9	48.4	-2.1	5.8	5.6	6.4	8.4
RoE-%						-2.8	8.9	7.8	8.3	10.2
P/E (x)						NA	8.1	8.5	7.4	5.6
EV/EBITDA						9.9	7.0	6.8	6.0	5.0

(Source: Company, HDFC sec)

Q3FY23 Result Review:

Consolidated revenue for the quarter stood at Rs. 1,852 Cr vs Rs. 1,438 Cr in Q3FY22, up 28.8%. This was led by a 17.7% YoY increase in the sales volume of DI pipes to 1,92,000 tons, offset by a 7.6% YoY decrease in the sales volume of Ductile fittings to 4,500 tons and decrease in Pig iron sales volume to 9,600 tons, down 55.8% YoY. EBITDA for the quarter stood at Rs. 187 Cr vs 190 Cr in Q3FY22. EBITDA margin for the quarter decreased by 307 bps to 10.1% vs 13.2% in the corresponding quarter last year, due to a significant increase in the material cost. Profit after tax for Q3FY23 came in at Rs. 78 Cr vs Rs. 97 Cr, attributable to an increase in the finance cost from Rs. 45 Cr in Q3FY22 to Rs. 77 Cr in the current quarter.

Key Developments and Triggers:

Robust demand

The global ductile iron pipe market is predicted to grow at a 6% CAGR from FY2022 to 2030, and the Indian market is expected to grow at a much higher CAGR of 13 – 15% due to huge investment by the government in infrastructure. Ductile iron pipes have a wide range of application in the public infrastructure works, which include potable water distribution, irrigation, and sewage and wastewater transportation among others. The major demand drivers for DI Pipes include:

Jal Jeevan and AMRUT Missions

The government envisioned the Jal Jeevan and AMRUT Missions to provide safe and adequate drinking water through individual household tap connections by 2024 to all households in rural India. The government has planned an outlay of Rs. 3.6 lakh crores under the project. Government of India has also launched the Jal Jeevan Mission (urban)/AMRUT 2.0 scheme to cover the uncovered areas in the urban conglomeration. The main aim is to make 500 identified AMRUT cities “water secure”, i.e., providing water connection to all households.

Sewerage and Wastewater Management

Sewerage disposal in many cities and town are not up to the mark. With increasing urbanisation, draining out dirty water and keeping the cities clean is a matter of increasing concern. A number of new sewerage schemes are coming in many of the towns and cities that will require DI pipes, though mainly for the force mains. A number of projects are already under implementation under the 'Namami Gange' and other state Government schemes.

Irrigation

Irrigation is a new avenue and the demand from this segment is in the nascent stages. Traditionally, irrigation in India has been mainly canal based. However to minimize the transmission loss due to percolation and evaporation and to avoid the complication of land acquisition, there is a growing acceptance of piped irrigation systems in the country. A number of piped irrigation systems are coming up in many states and other states are trying out model schemes, before going the big way. Demand for DI pipes is expected to grow as more and more states benefit from the piped irrigation system.

Industrial Water

Rapid pace of Industrialisation is the backbone of the economic development in India. More and more industries are coming up and with the increase in industrialization, the demand for Industrial water supply is also growing. Growth in the real estate too will add to the growing demand for Industrial water.

The plants are operating at full capacity with ECL achieving its highest ever Q3 production and sales. The demand is strong and the company has an orderbook of 7 months, which is expected to increase given the thrust by the government.

Merger with Srikalahasthi Pipes and capacity expansion

Srikalahasthi Pipes Limited merged with ECL effective from December 31, 2021. The merger has led to significant economies of scale as well as commanding ~30% of the total domestic market share in terms of operational capacity. Further, ECL got the advantage of backward integration through this merger. Previously it had to buy Pig Iron used in the manufacture of CI Pipes from the open market, but now sources it internally.

The management has undertaken capex in Srikalahasthi in two phases; capacity increased by 1 LTPA in the first phase. Another 1 - 1.5 LTPA capacity is being added in phase two. The project faced delays due to sourcing issues from China but is now progressing well. The management expects the capacity to come on-stream by March 2024. Another 40,000 TPA capacity is being added in the eastern unit as well. The management expects to increase its capacity from the present ~7 LTPA to ~9 LTPA by the end of FY24. Rs. 400 Cr will be required to complete the balance portion of the capacity addition. The present capacities are running at more than 100% utilization and thus the additional production will be easily absorbed in the market.

Leading position in industry with backward integrated plants

The company has plants in South and East India, which help it cater to the central, northern, eastern and southern markets in the country. DI pipes are bulky in nature and transportation across the country is not feasible. Hence, markets for all players are segmented. Further, except for a coking coalmine and an iron ore mine, all the facilities of ECL are fully backward integrated. The company has its own coke oven batteries, which converts the imported coking coal into coke. The waste heat gases generated from the coke oven batteries are used to generate power via the captive power plants. The captive power plants help in reducing the power cost to a big extent. The company also has a sinter plant that is used to convert iron ore fines into sinter. This helps the company to avoid buying iron ore lumps, which are expensive compared to fines. ECL produces its own ferro silicon, which is required in the manufacturing process. The company also produces its own cement and paint, as DI Pipes require an internal cement coating and external paint coating to provide strength and avoid corrosion. This backward integration helps the company be cost competitive and maintain the quality of its products.

Strong financial position

Credit metrics of the company improved in FY22. Interest cover ratio, which was in the range of 1.5x – 1.9x from FY19 – FY21, increased to 3.3x in FY22. Debt to equity for the company has been below 1 for the past 5 years. Net Debt as on December 31, 2022 stood at Rs. 2,650 Cr out of which Rs. 1,050 Cr is long-term debt. ECL has repayments of Rs. 350 Cr in FY24 and Rs. 250 – 260 Cr in FY25, which will further reduce the finance cost. Additionally, ECL's working capital cycle had increased due to the raw material inflation. The company had increased the inventory of coking coal when the prices started to rise, thus requiring additional funds. With lower iron ore and coking coal prices, the short-term debt shall reduce too.

Risks and Concerns:

Volatility in input prices

Raw material consumption forms the single largest cost component for ECL. It formed about ~47.2% of sales in FY22 and ~54.6% in 9MFY23. Upon de-allocation of the coalmines and further delay in the receipt of the environmental and other clearances for the iron ore mines, the company has to resort to the open market for meeting its requirement of the key inputs (iron ore and coal) at the prevailing market prices. Hence, any adverse movement in raw material price without any corresponding movement in finished good price affects the profitability of the company. The prices of finished goods generally move in tandem with that of raw materials though with a time lag, which exposes the company to risk arising on account of volatility in the raw material prices.

Funds stuck in coal block

A coking coalmine was allocated to the company in 2006, which was de-allocated in 2014-15 and handed over to Bharat Coking Coal Limited. ECL has claimed an amount of Rs. 1,532 Cr (Rs. 1289 Cr principal + interest) as compensation. The matter of calculation of compensation was under litigation and the compensation is yet to be finalized by the Nominated Authority/Ministry of Coal based on the directions of the High Court. There is no clarity on the timeline of receipt of the compensation.

ECL is carrying a majority the amount spent by it on mine development as part of Capital WIP. In case, the decision does not come in favour of ECL, then it may have to write off the amount denting its reserves. Delay in receiving the compensation would mean higher interest charge borne for longer.

Foreign exchange risk

ECL has forex exposure in the form of forex payable (for import of coking coal & coke), foreign currency borrowings (in the form of external commerical borrowings) and forex receivable (for export of DI Pipes and Fittings). While the exports of the final goods and import of the raw materials provide a natural hedge to the company and mitigates the foreign exchange fluctuation risk to a certain extent, the timing difference of the exports and imports exposes the company towards volatile foreign currency movement.

Inter-Corporate deposits

The company has advanced inter corporate deposits to its group companies. It received back Rs. 25 Cr during Q3FY23 and the balance amount of Rs. 200 Cr is expected to be collected before the end of the financial year. Any default by the group companies in repayment of the ICD's will be a negative for the company.

Elavur land dispute

ECL had mortgaged the land of Elavur plant in favour of a lender of Electrosteel Steels Limited (ESL), an erstwhile associate company. Subsequently, Insolvency process was initiated against ESL and the company was admitted under IBC where Vedanta discharged the entire debt and acquired ESL. The lender had assigned its right to another entity (UVARCL), which has claimed symbolic possession of the Elavur land. ECL has disputed the possession and the matter is under litigation. The land has been recorded at its existing carrying value (~Rs. 295 Cr) and no provision/impairment has been provided.

Working capital intensive operations

The business of the company is working capital intensive in nature due to higher collection period and higher inventory days. The high collection period is because of the customer's profile mainly being Government bodies, where the payment terms remains stretched and export sales involves a considerable time gap between dispatch and final acceptance. Inventory period is high as the company has to maintain higher level of raw materials for ensuring uninterrupted production. The management strives to maintain the WC days around 5 – 5.5 months.

Competition from new capacity

The company may face competition as Welspun has also added a plant having capacity of 400000 TPA in FY23. However, the management believes that the additional capacity will not add competitive pressure as demand is robust and the Welspun plant will cater to the western region of India, while ECL has presence in the south and eastern markets.

About the company:

Electrosteel Castings Limited (ECL) has more than six decades of experience in the water infrastructure business. They are the largest manufacturers of Ductile Iron (DI) Pipes in the Indian sub-continent, having a production capacity of ~7,00,000 TPA. Back in 1994, the company had pioneered the setup of a Ductile Iron Spun Pipe plant in India. The company has a strong brand presence around the globe. Their Pipes and Fittings are exported to more than 110+ countries across 5 continents. They cater to a large customer base spread around the Indian subcontinent, Europe, North and South America, South East Asia, Middle East and Africa and are the largest exporters of Ductile Iron Pipes in the nation. Their manufacturing operations are spread across 5 facilities:

Khardah Works (KW) is one of the main two units situated at Khardah near Kolkata, where Electrosteel's Ductile Iron Pipes are manufactured. It has facilities for producing 2.80 Lakh TPA of Ductile Iron pipe right from producing the base metal in Blast Furnace to pipe casting and finishing. It has a Blast Furnace Gas based captive power plant and a 3.6 Lakh TPA sinter plant. It also has facilities for producing Ductile Iron fittings 10,200 TPA and Flange Pipes.

Srikalahasthi Works (SW) of Electrosteel has a state-of-the-art manufacturing facility in Rachagunneri Village on Tirupati-Srikalahasthi Road, Tirupati District of Andhra Pradesh. The integrated facility is spread across 242 acres. The 4,00,000 TPA Ductile Iron Pipe Plant is integrated with the 5,25,000 TPA Mini Blast Furnace, 2,80,000 TPA Coke Oven Plant, 22 MW Waste Heat Recovery captive Power Plant 2,00,000 TPA Cement Plant, 16,000 TPA Ferro Silicon Plant and 5 MLD Municipal Sewage Water Recycling Plant. The Blast Furnace Gas from the Mini Blast Furnace caters to various energy requirements, thereby reducing carbon emission significantly.

Haldia Works (HW) is located in the Industrial town of Haldia in West Bengal. It has a 3,24,000 TPA Coke Oven Plant and 2 X 100 TPD Sponge Iron unit. They also have a DI fittings and Accessories plant of 10,800 TPA and one 9 MVA Ferro-Alloy producing unit. A 17 MW

Waste Heat Recovery Power Plant is also located here, which generates power using the waste heat of Coke Oven Plant and Sponge Iron Plant.

Bansberia Works (BW), spread over 22 acres of land, is an ultra-modern DI Pipe coating and finishing plant. It is located at Bansberia near Kolkata. The wide range of linings and coatings allow ECL to produce premium quality bespoke pipes to suit the unique needs of each of their customers. This unit exclusively caters to the export clientele.

Elavur Works (EW) is located near Chennai in Tamil Nadu. ECL has a 36,000 TPA Cast Iron Spun Pipe manufacturing facility, the biggest Cast Iron Pipe manufacturing facility in India.

Revenue Mix	FY22	%
DI Pipes	3524.50	71%
Ferro Products	301.55	6%
DI Fittings	252.22	5%
CI Pipes	116.49	2%
Cement	19.67	0%
Others	784.21	16%
Total	**4998.64**	**100%**

Customer Profile	%
Direct State Govt. departments like PHED/Water supply	20%
Direct Central Govt departments like MES/Railways etc.	5%
Govt./ Semi Govt. City Water supply / Sewerage boards (like KMDA)	10%
City/Town municipalities/or Municipal corporations	5%
Private small local contractors who work for Govt. Semi Govt. agencies	10%
Big Turn-key contractors like L&T, Megha, NCC etc.	50%

Peer comparison:

	Mcap (Rs. Cr)	Sales				EBITDA Margin (%)				PAT				RoE (%)				P/E (x)			
		FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E
ECL	2800.6	5281	7404	7996	9116	13.2	10.7	11.0	11.5	348	330	378	502	8.9	7.8	8.3	10.2	8.1	8.5	7.4	5.6
Jindal Saw	5547.7	13298	17435	18701	20383	10.5	9.7	10.4	10.4	412	528	719	851	5.7	7.0	8.7	9.5	13.5	11.4	7.5	6.4

(Source: Bloomberg, Company, HDFC sec)

Financials (Consolidated)

Income Statement

(Rs Cr)	FY21	FY22	FY23E	FY24E	FY25E
Net Revenues	**3474**	**5281**	**7404**	**7996**	**9116**
Growth (%)	***28.2***	***52.0***	***40.2***	***8.0***	***14.0***
Operating Expenses	3040	4583	6612	7117	8067
EBITDA	**434**	**698**	**792**	**880**	**1048**
Growth (%)	***18.5***	***60.9***	***13.5***	***11.0***	***19.2***
EBITDA Margin (%)	***12.5***	***13.2***	***10.7***	***11.0***	***11.5***
Depreciation	90	115	121	127	148
Other Income	53	56	63	56	46
EBIT	**397**	**639**	**734**	**808**	**946**
Interest expenses	208	195	292	302	275
PBT	**-56**	**444**	**442**	**506**	**671**
Tax	40	97	111	128	169
PAT	**-96**	**348**	**330**	**378**	**502**
Share of Asso./Minority Int.	6	0	0	0	0
Adj. PAT	**-91**	**347**	**330**	**378**	**502**
Growth (%)	***-156.6***	***-480.9***	***-4.8***	***14.5***	***32.6***
EPS	-2.1	5.8	5.6	6.4	8.4

Balance Sheet

As at March (Rs Cr)	FY21	FY22	FY23E	FY24E	FY25E
SOURCE OF FUNDS					
Share Capital	43	59	59	59	59
Reserves	3683	4044	4326	4645	5087
Shareholders' Funds	**3726**	**4103**	**4386**	**4705**	**5147**
Minority Interest	2	1	2	2	2
Total Debt	2138	2967	3248	2798	2548
Net Deferred Taxes	362	345	325	325	325
Other Non-curr. Liab.	111	97	74	80	91
Total Sources of Funds	**6338**	**7514**	**8034**	**7909**	**8113**
APPLICATION OF FUNDS					
Net Block & Goodwill	2633	2763	2761	3083	2996
CWIP	1337	1208	1268	1188	1188
Investments	202	457	207	122	97
Other Non-Curr. Assets	103	67	63	68	77
Total Non Current Assets	**4275**	**4494**	**4298**	**4461**	**4358**
Inventories	1229	2238	2333	2410	2747
Debtors	769	942	1320	1468	1673
Cash & Equivalents	510	519	516	285	143
Other Current Assets	369	431	733	591	674
Total Current Assets	**2877**	**4129**	**4902**	**4755**	**5238**
Creditors	449	627	649	745	849
Other Current Liab & Provisions	364	483	517	561	634
Total Current Liabilities	**814**	**1110**	**1166**	**1306**	**1483**
Net Current Assets	2064	3019	3736	3448	3755
Total Application of Funds	**6338**	**7514**	**8034**	**7909**	**8113**

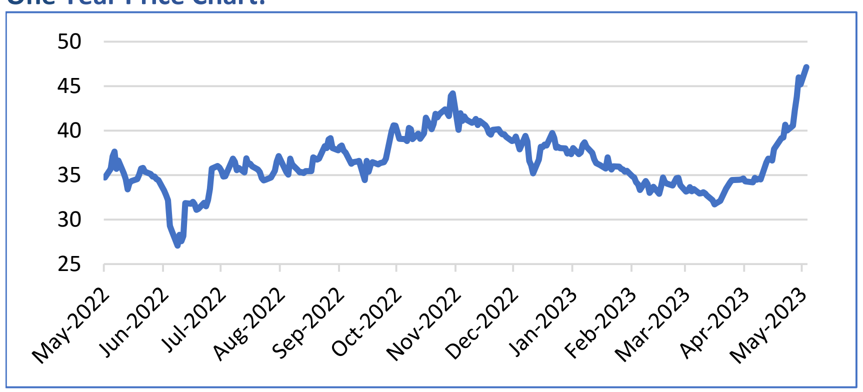
(Source: Company, HDFC sec)

Electrosteel Castings Ltd

Cash Flow Statement

(Rs Cr)	FY21	FY22	FY23E	FY24E	FY25E
Reported PBT	-56	444	442	506	671
Non-operating & EO items	238	-4	-61	1	2
Interest Expenses	178	162	292	302	275
Depreciation	90	115	121	127	148
Working Capital Change	41	-880	-719	57	-449
Tax Paid	-46	-116	-132	-128	-169
OPERATING CASH FLOW (a)	**444**	**-279**	**-57**	**866**	**477**
Capex	-132	-179	-179	-370	-60
Free Cash Flow	312	-458	-236	496	417
Investments	30	-191	250	85	25
Non-operating income	231	41	42	0	0
INVESTING CASH FLOW (b)	**129**	**-329**	**113**	**-285**	**-35**
Debt Issuance / (Repaid)	-195	823	281	-450	-250
Interest Expenses	-211	-186	-292	-302	-275
FCFE	167	28	45	-172	-83
Share Capital Issuance	0	0	0	0	0
Dividend	-13	-27	-48	-59	-59
Others	0	0	0	0	0
FINANCING CASH FLOW (c)	**-419**	**609**	**-59**	**-812**	**-585**
NET CASH FLOW (a+b+c)	**154**	**1**	**-2**	**-231**	**-142**

One Year Price Chart:



(Source: Company, HDFC sec)

Key Ratios

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Profitability Ratios (%)					
EBITDA Margin	12.5	13.2	10.7	11.0	11.5
EBIT Margin	11.4	12.1	9.9	10.1	10.4
APAT Margin	-2.6	6.6	4.5	4.7	5.5
RoE	-2.8	8.9	7.8	8.3	10.2
RoCE	7.7	9.9	10.0	10.7	12.5
Solvency Ratio (x)					
Net Debt/EBITDA	3.8	3.5	3.4	2.9	2.3
Net D/E	0.4	0.6	0.6	0.5	0.5
PER SHARE DATA (Rs)					
EPS	-2.1	5.8	5.6	6.4	8.4
CEPS	0.0	7.8	7.6	8.5	10.9
BV	86.1	69.0	73.8	79.1	86.6
Dividend	0.3	0.8	1.0	1.0	1.0
Turnover Ratios (days)					
Debtor days	73	59	56	64	63
Inventory days	112	120	113	108	103
Creditors days	44	37	31	32	32
VALUATION					
P/E (x)	NA	8.1	8.5	7.4	5.6
P/BV (x)	0.5	0.7	0.6	0.6	0.5
EV/EBITDA (x)	9.9	7.0	6.8	6.0	5.0
EV / Revenues (x)	1.2	0.9	0.7	0.7	0.6
Dividend Yield (%)	0.5	1.7	2.1	2.1	2.1
Dividend Payout (%)	-11.9	13.7	18.0	15.7	11.9

(Source: Company, HDFC sec)

NIRMAM ANIL MEHTA

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HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:

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HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066

Compliance Officer: Murli V Karkera Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

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